No. ~~1249~~ 94

In the Supreme Court of the United States

OCTOBER TERM, 1941

MOTHER LODE COALITION MINES COMPANY,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 11–20), is reported in 42 B. T. A. 596. The opinion of the circuit court of appeals (R. 85–90) is reported in 125 F. (2d) 657.

JURISDICTION

The judgment of the circuit court of appeals was entered February 21, 1942. (R. 90–91.) The petition for a writ of certiorari was filed May 19, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether an income tax return for 1934 which reports gross income but no net income from a mining property is "the first return" made by the taxpayer under the Revenue Act of 1934 "in respect of" such property within the meaning of Section 114 (b) (4) of that Act.

2. Whether a taxpayer which in its 1932 income tax return elected under Section 114 (b) (4) of the Revenue Act of 1932 to take percentage depletion, may take percentage depletion for the year 1935 under Section 114 (b) (2) of the Revenue Act of 1934 without making a new election under the later statute.

STATUTES AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra*, pp. 8–20.

STATEMENT

The taxpayer is a corporation operating a metal mining property near Kennecott, Alaska (R. 12). During the years prior to 1933, taxpayer had taken deductions on account of depletion which exhausted its cost basis (R. 12, 44). In its income tax return for 1933 it stated (R. 12–13):

> Under the provisions of Section 114 (b) (4) of the Revenue Act of 1932 the taxpayer elects to deduct depletion on the percentage basis for the year 1933 and thereafter.

In 1934 taxpayer did not extract ore from its property but it did sell ore mined in previous years

(R. 12). In its income tax return for that year it reported total income of $27,865.12 and total deductions of $66,763.38 (R. 13). Taxpayer did not claim any deductions for depletion and did not state when it filed its 1934 return whether it elected to take percentage depletion under Section 114 (b) (4) of the Revenue Act of 1934 for the taxable year 1934 and thereafter (R. 13, 14).

In 1935 the taxpayer mined its properties and derived a net profit from the operation (R. 12). In its return for 1935 it claimed a deduction of $25,276.88 for percentage depletion, stating in support of the claim (R. 12):

> Under the provisions of Section 114 (b) (4) of the Revenue Act of 1932 the taxpayer elected to deduct depletion on the percentage basis for the year 1933 and thereafter.

The Commissioner disallowed the percentage depletion deduction for 1935, ruling that Section 114 (b) (4) of the Revenue Act of 1934 required a new election of the basis for computing depletion in respect of a property to be made in the first return filed by the taxpayer under that Act in respect of such property and that the taxpayer's failure to make an affirmative election in its 1934 return constituted an election to compute depletion thereafter without reference to percentage depletion (R. 14–15).

The taxpayer appealed to the Board of Tax Appeals. The Board found the facts above stated

(R. 11–15) and approved the Commissioner's determination of a deficiency based upon disallowance of the deduction (R. 20). The taxpayer then appealed to the Circuit Court of Appeals for the Second Circuit. The court held that the taxpayer's 1934 return was its first return under the Revenue Act of 1934 in respect of the property, regardless of whether it reported net income, and that, having failed to make an affirmative election to take percentage depletion in its return for 1934, the taxpayer could not make such an election in its return for 1935. The court also held that the election stated in taxpayer's 1933 return was not sufficient for subsequent years because Section 114 (b) (4) of the Revenue Act of 1934 required a new election to be made in the first return filed under that Act. Accordingly, the court affirmed the decision of the Board of Tax Appeals (R. 90–91).

ARGUMENT

1. The decision of the court below is in conflict with the decision of the Circuit Court of Appeals for the Third Circuit in *Pittston-Duryea Coal Co.* v. *Commissioner*, 117 F. (2d) 436, upon the question whether the election made in the 1935 return entitled taxpayer to percentage depletion notwithstanding its failure to make such an election in its 1934 return. Both courts have recognized the conflict. See R. 90; *Tonopah Mining Co.* v. *Commissioner* (C. C. A. 3d), decided March 17, 1942, not

yet officially reported but found in 1942 C. C. H., p. 9782. Accordingly, although we believe the decision below to be correct, we do not oppose the granting of certiorari with respect to this issue.

2. Taxpayer argues as a second contention that the election to take percentage depletion made in its 1933 return constituted a valid election for all subsequent years and thus complied with Section 114 (b) (4) of the Revenue Act of 1934 (Pet. 6–7). The argument has no merit. Section 114 (b) expressly provides that:

> A taxpayer making his first return under this title [Title I] in respect of a property shall state whether he elects to have the depletion allowance * * * computed with or without regard to percentage depletion * * *. If the taxpayer fails to make such statement in the return, the depletion allowance * * * shall be computed without reference to percentage depletion. * * *

As the court below stated, these words are quite explicit. An income tax return for 1933 is not the first return under Title I of the Revenue Act of 1934.

In spite of the plain words of the statute requiring all taxpayers to state an election in their first return under the 1934 Act, taxpayer relies upon the Committee reports explaining that Section 114 (b) (4) "permitted" taxpayers to make a new election in order to avoid "administrative complexities." H. Rep. No. 704, 73d Cong., 2d Sess., p. 29;

S. Rep. No. 558, 73d Cong., 2d Sess., p. 36. It argues from that language that a new election was not required if the taxpayer had already elected to take percentage depletion. But, apparently, the complexities to which the Committees referred were those of checking the elections made in 1933 and this consideration would apply to previous statements of an election to take percentage depletion just as much as to failures so to elect. Hence it seems that all that was intended by use of the permissive was to indicate that a taxpayer might state an election to take percentage depletion or else remain silent and have his deduction for depletion calculated on a cost basis.[1] But whatever the explanation, the inference which taxpayer would draw is too tenuous to warrant interpolating an exception into the plain words of the statute to cover the case of those who made an election under the 1932 Act.

There is no necessary connection between this second question and the first question presented. There is no conflict of decisions upon this second question nor is there any indication that it has any present importance in the administration of the revenue acts. Accordingly, we submit that if certiorari is granted, the writ should be limited to

[1] Section 114 (b) (4) of the Revenue Acts of 1936 and 1938 and of the Internal Revenue Code make binding for the future the first election made under one of those acts but not an election made under the Revenue Act of 1932. Thus, they differ somewhat from the Revenue Act of 1934.

the first question presented and that as to this second question the petition should be denied.

Respectfully submitted.

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APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the

absence of such provisions, on the basis of the trust income allocable to each. (For percentage depletion allowable under this subsection, see section 114 (b), (3) and (4).)

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The Basis of property shall be the cost of such property; except that—

(1) *Inventory value.*—If the property should have been included in the last inventory, the basis shall be the last inventory value thereof.

* * * * *

(b) *Adjusted basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

(1) *General rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other dis-

position of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * * *

(4) *Percentage depletion for coal and metal mines and sulphur.*—The allowance for depletion under section 23 (m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property. A taxpayer making his *first return* under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion. The method, determined as above, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer, or of any other person if the basis of the property (for determining gain) in his hands is, under section 113, determined by reference to the basis in the hands of such taxpayer,

either directly or through one or more substituted bases, as defined in that section. [Italics supplied.]

Revenue Act of 1932, c. 209, 47 Stat. 169:

Sections 23 (l) and (m), 113 (a) (1), and 114 (b) (1) of the Revenue Act of 1932 are either identical or substantially so, with Sections 23 (m) and (n), 113 (a) (1) and (b) (1), and 114 (b) (1) of the Revenue Act of 1934, and for that reason are not set out *haec verba* herein. There are, however, substantial differences between Section 114 (b) (4) of the Revenue Act of 1932 and Section 114 (b) (4) of the Revenue Act of 1934. Section 114 (b) (4) of the Revenue Act of 1932 is therefore set out in full, and is as follows:

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

* * * * *

(4) *Percentage depletion for coal and metal mines and sulphur.*—The allowance for depletion shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance for the taxable year 1932 or 1933 be less than it would be if computed without

reference to this paragraph. A taxpayer making return for the taxable year 1933 shall state in such return, as to each property (or, if he first makes return in respect of a property for any taxable year after the taxable year 1933, then in such first return), whether he elects to have the depletion allowance for such property for succeeding taxable years computed with or without reference to percentage depletion. The depletion allowance in respect of such property for all succeeding taxable years shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for succeeding taxable years shall be computed without reference to percentage depletion. During the period for which property acquired after December 31, 1933, is held by the taxpayer—

(A) if the basis of the property in the hands of the taxpayer is, under section 113 (a), determined by reference to the basis in the hands of the transferor, donor, or grantor, then the depletion allowance in respect of the property shall be computed with or without reference to percentage depletion, according to the method of computation which would have been applicable if the transferor, donor, or grantor had continued to hold the property, or

(B) if the basis of the property is, under section 113 (a), determined by reference to the basis of other property previously held by the taxpayer, then the depletion allowance in respect of the property shall be computed with or without reference to percentage depletion, according to the method of computation which would have been applicable in

respect of the property previously held if the taxpayer had continued to hold such property.

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23 (m)–1. *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.*—Section 23 (m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under these provisions of the Act the owner of an interest in mineral deposits, mineral properties, or timber, whether freehold or leasehold, is allowed annual depletion and depreciation deductions which, in the aggregate, will return to him the cost or other basis of such property as provided in section 113, plus, in either case, subsequent allowable capital additions (see articles 23 (m)–15 and 23 (m)–16) with the following exceptions and qualifications:

* * * * *

(2) In the case of coal mines, metal mines, and sulphur mines or deposits the aggregate annual allowable deductions may never be as great as the cost or other basis, if an election of the percentage depletion method is made in his first return under Title I of the Act; and

* * * * *

When used in these articles (23m)-1 to 23 (m)-28) covering depletion and depreciation—

* * * * *

(*g*) "Gross income from the property" as used in section 114 (b) (3) and (4) and articles 23 (m)-1 to 23 (m)-28, inclusive, means the amount for which the taxpayer sells (a) the crude mineral product of the property or (b) the product derived therefrom, not to exceed in the case of (a) the representative market or field price (as of the date of sale) of crude mineral product of like kind and grade before transportation from the immediate vicinity of the mine or well, or in the case of (b) the representative market or field price (as of the date of sale) of a product of the kind and grade from which the product sold was derived, before the application of any processes (to which the crude mineral product may have been subjected after emerging from the mine or well) with the exception of those listed below, and before transportation from the place where the last of the processes listed below was applied. If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes minus the costs (including transportation costs) of the processes not listed below. The processes excepted are as follows:

(1) In the case of coal—cleaning, breaking, sizing, and loading at the mine for shipment;

(2) In the case of sulphur—pumping to vats, cooling, breaking, and loading at the mine for shipment;

(3) In the case of iron ore and ores which are customarily sold in the form of the crude mineral product—sorting or concentrating to bring to shipping grade, and loading at the mine for shipment; and

(4) In the case of lead, zinc, copper, gold, or silver ores and ores which are not customarily sold in the form of the crude mineral product—crushing, concentrating (by gravity or flotation), and other processes to the extent to which they do not beneficiate the product in greater degree (in relation to the crude mineral product on the one hand and the refined product on the other) than crushing and concentrating (by gravity or flotation).

In all cases there shall be excluded in determining the "gross income from the property" an amount equal to any rents or royalties which were paid or incurred by the taxpayer in respect of the property and are not otherwise excluded from the "gross income from the property." If royalties in the form of bonus payments or advanced royalties (see article 23 (m)–10) have been paid in respect of the property in the taxable year or in prior years, the amount excluded from "gross income from the property" for the taxable year on account of such payments shall be an amount equal to that part of such payments which is allocable to the products sold during the taxable year.

(*h*) "Net income of the taxpayer (computed without allowance for depletion) from the property," as used in section 114 (b) (2), (3), and (4) and articles 23 (m)–1 to 23 (m)–28, inclusive, means the "gross income from the property" as defined in paragraph (*g*) less the allowable deductions attribut-

able to the mineral property upon which the depletion is claimed and the allowable deductions attributable to the processes listed in paragraph (*g*) in so far as they relate to the product of such property, including overhead and operating expenses, development costs properly charged to expense, depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. Deductions not directly attributable to particular properties or processes shall be fairly allocated. To illustrate: In cases where the taxpayer engages in activities in addition to mineral extraction and to the processes listed in paragraph (*g*), deductions for depreciation, taxes, general expenses, and overhead, which can not be directly attributed to any specific activity, shall be fairly apportioned between (1) the mineral extraction and the processes listed in paragraph (*g*) and (2) the additional activities, taking into account the ratio which the operating expenses directly attributable to the mineral extraction and the processes listed in paragraph (*g*) bear to the operating expenses directly attributable to the additional activities. If more than one mineral property is involved, the deductions apportioned to the mineral extraction and the processes listed in paragraph (*g*) shall, in turn, be fairly apportioned to the several properties, taking into account their relative production.

* * * * *

ART. 23. (m)–5. *Computation of depletion based on a percentage of income in the case of coal mines, metal mines, and sulphur mines or deposits.*—Under section 114 (b) (4) a taxpayer may deduct for depletion an amount equal to 5 per cent of the gross income from the property during the taxable

year in the case of coal mines, an amount equal to 15 per cent of the gross income from the property during the taxable year in the case of metal mines, and an amount equal to 23 per cent of the gross income from the property during the taxable year in the case of sulphur mines or deposits, but such deduction shall not in any case exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. (For definitions of "gross income from the property" and "net income of the taxpayer (computed without allowance for depletion from the property," see article 23 (m)-1 (*g*) and (*h*).)

In his first return made under Title I of the Act (for a taxable year beginning after December 31, 1933) the taxpayer must state as to each property with respect to which the taxpayer has any item of income or deduction whether he elects to have the depletion allowance for each such property for the taxable year computed with or without reference to percentage depletion. An election once exercised under section 114 (b) (4) and this article can not thereafter be changed by the taxpayer, and the depletion allowance in respect of each such property will for all succeeding taxable years be computed in accordance with the election so made. If the taxpayer fails to make such statement in the return in which the election should be so indicated, the depletion allowance for the year for which an election must be first exercised and for all succeeding taxable years will be computed without reference to percentage depletion. The method, determined under section 114 (b) (4) and this article, of computing the depletion allowance shall be applied in the case of the property for all

taxable years in which it is in the hands of such taxpayer, or of any other person if the basis of the property (for determining gain) in his hands is, under section 113, determined by reference to the basis in the hands of such taxpayer, either directly or through one or more substituted bases, as defined in that section.

ART. 114–1. *Basis for allowance of depreciation and depletion.*—The basis upon which exhaustion, wear and tear, obsolescence, and depletion will be allowed in respect of any property is the same as is provided in section 113 (a), adjusted as provided in section 113 (b), for the purpose of determining the gain from the sale or other disposition of such property, except as provided in article 23 (m)–3, relating to depletion based on discovery value, in article 23 (m)–4, relating to percentage depletion in the case of oil and gas wells, and in article 23 (m)–5, relating to percentage depletion in the case of coal mines, metal mines, and sulphur mines or deposits.

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

Articles 221 (g) and (h) and 611, promulgated under the Revenue Act of 1932, are identical or substantially so, with Articles 23 (m)–1 (2) and (g) and (h) and 114–1 of Treasury Regulations 86, promulgated under the Revenue Act of 1934, and are for that reason not set out herein. There are, however, substantial differences between Article 225 of Treasury Regulations 77 and the corresponding Article 23 (m)–5, of Treasury Regulations 86. Article 225 of Treasury Regulations 77, is therefore set out in full, and is as follows:

ART. 225. *Computation of depletion based on a percentage of income in the case of coal mines, metal mines, and sulphur mines or deposits.*—Under section 114 (b) (4) a taxpayer may deduct for depletion an amount equal to 5 per cent of the gross income from the property during the taxable year in the case of coal mines, an amount equal to 15 per cent of the gross income from the property during the taxable year in the case of metal mines, and an amount equal to 23 per cent of the gross income from the property during the taxable year in the case of sulphur mines or deposits, but such deduction shall not in any case exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. (For definitions of "gross income from the property" and "net income of the taxpayer (computed without allowance for depletion) from the property," see article 221 (g) and (h).) For the taxable years 1932 and 1933 the deduction computed under this article shall not be less than it would be if computed upon the cost or other basis provided in section 113 and articles 591–606.

In the return for the taxable year 1933 the taxpayer must state as to each property whether he elects to have the depletion allowance for each property for 1934 and succeeding taxable years computed with or without reference to percentage depletion. In the case of any property in respect of which a return is first made by the taxpayer in a year subsequent to 1933, the taxpayer must state as to each property whether he elects to have the depletion allowance for succeeding taxable years computed with or without ref-

erence to percentage depletion. An election once exercised under section 114 (b) (4) and this article can not thereafter be changed by the taxpayer, and the depletion allowance in respect of each such property will for all succeeding taxable years be computed in accordance with the election so made. If the taxpayer fails to make such statement in the return in which the election should be so indicated, the depletion allowance for the year for which an election must be first exercised and for all succeeding taxable years will be computed without reference to percentage depletion. No right of election exists, however, in the case of property acquired by the taxpayer after December 31, 1933, (1) if the basis of the property in the hands of the taxpayer is determined under section 113 (a) by reference to the basis in the hands of the transferor, donor, or grantor, or (2) if the basis of the property is determined under section 113 (a) by reference to the basis of other property previously held by the taxpayer. In such cases the depletion allowance in respect of the property will be computed with or without reference to percentage depletion, in cases falling under (1) according to the method of computation which would have been applicable if the transferor, donor, or grantor had continued to hold the property, or in cases falling under (2) according to the method of computation which would have been applicable in respect of the property previously held if the taxpayer had continued to hold such property.

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